

## Accounting for Lease-Purchase Agreements (Capital Leases)

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One of the most common ways school districts acquire equipment is through lease-purchase agreements.

*Governmental Accounting and Financial Reporting Standards (GASB Codification)*  
Section L20.109 requires that a lease agreement that meets any one of the following criteria be capitalized:

1. The lease transfers ownership of the property to the lessee by the end of the lease term. *This is a common situation in LEAs.*
2. The lease contains a bargain purchase option. *This is a common situation in LEAs.*
3. The lease term is equal to 75 percent or more of the estimated economic life of the leased property.
4. The value at the beginning of the lease's term of the minimum lease payments, excluding that portion of the payments representing executory costs to be prepaid by the lessor but including any profit thereon, equals or exceeds 90 percent of the excess of the fair value of the leased property to the lessor at the inception of the lease.

When lease agreements are capitalized, the property rights acquired under the lease are reported in the government-wide statement of net assets.

The following rules apply to accounting for capital leases in the governmental funds:

1. At the inception of the lease, record the capital lease in the fund acquiring the asset as a debit to Object 6400 for the amount of the entire principal that is due. The credit is to account 8972, Proceeds from Capital Leases.
2. As lease payments are made, record the payments in the fund acquiring the asset as a debit to accounts 7439, Debt Service - Principal, and 7438, Debt Service - Interest.

As an example of accounting for a capital lease, assume that a photocopy machine used in the accounting department is leased for a five-year period, which is the economic life of the equipment. The lease is signed on June 30, 1992, and beginning on this date, five annual payments of \$50,000 will be made.

The lease agreement contains the following amortization schedule, which shows the breakdown of the annual payments into the principal and interest components:

### Amortization Schedule

<i>Date</i>	<i>Lease Payment</i>	<i>Interest Expenditure @ 10%</i>	<i>Principal Expenditure</i>	<i>Amount of Long-Term Debt<sup>1</sup></i>
6/30/92				\$208,493
6/30/92	\$ 50,000		\$ 50,000	158,493
6/30/93	50,000	\$15,849	34,151	124,342
6/30/94	50,000	12,434	37,566	86,776
6/30/95	50,000	8,678	41,322	45,454
6/30/96	50,000	4,546	45,454	-0-
	\$250,000	\$41,507	\$208,493	

<sup>1</sup>This column was computed from the amortization schedule provided in the lease agreement. To compute this column, subtract the amount of principal paid each year from the total principal due at the beginning of the lease.

This amortization schedule is necessary to make the entries that are needed to record the capital lease.

The entries for the photocopy machine would be recorded as follows:

<b>General Fund</b>			
		<i>Dr</i>	<i>Cr</i>
<b>x-xx-xx</b>	<b>Equipment</b>		
	01-0000-0-0000-7200-6400-000	\$208,493	
	Proceeds from Capital Leases		
	01-0000-0-0000-0000-8972-000		\$208,493
	To record the acquisition of equipment with a capital lease		
<b>General Fund</b>			
		<i>Dr</i>	<i>Cr</i>
<b>x-xx-xx</b>	<b>Debt Service - Principal</b>		
	01-0000-0-0000-9100-7439-000*	\$50,000	
	Cash		
	01-0000-0-0000-0000-9110-000		\$50,000
	To record the first lease payment		

\*If a restricted resource authorizes the expenditure of funds for a capital lease, the appropriate resource and goal would be used.

The second lease payment (6/30/93) would be recorded in the following manner:

<b>General Fund</b>			
		<i>Dr</i>	<i>Cr</i>
<b>x-xx-xx</b>	<b>Debt Service - Interest</b>		
	<b>01-0000-0-0000-9100-7438-000</b>	<b>\$15,849</b>	
	<b>Other Debt Service - Principal</b>		
	<b>01-0000-0-0000-9100-7439-000*</b>	<b>34,151</b>	
	<b>Cash</b>		
	<b>01-0000-0-0000-0000-9110-000</b>		<b>\$50,000</b>
	<b>To record the second lease payment</b>		

**\*If a restricted resource authorizes the expenditure of funds for a capital lease, the appropriate resource and goal would be used.**

If the lease payments are to be paid from a Debt Service Fund, any transfers from the General Fund to the Debt Service Fund are treated as operating transfers, not as General Fund expenditures.

